bidding. Vermont also gave preference to bidders who offered the continuity of an existing institution, as opposed to individual bidders. The Vermont system, as administered by NECA, has been working well, and may be an adequate administrative model for a federal program.

Schools and Libraries

The Maine Public Utilities Commission recently completed a ratemaking proceeding in which it required NYNEX to provide discounted and/or free service to schools and libraries in Maine. Attached to these comments are the portion of the Maine Commission's Orders and press releases. These may be useful in providing guidance to the Joint Board.

For these reasons, if the Commission should establish a cost-based mechanism to aid rural, insular and high-cost areas, it must also establish a low threshold at which carrier costs become eligible for assistance. The Commenters suggest that a cost equal to 110 percent of the national average should be established as the threshold for assistance. This could be expected to produce a high-to-low ratio of rates of approximately 120 percent or 125 percent.

Role of State Universal Service Programs

We noted above that the achievement of reasonably comparable rates is a federal responsibility, although the 1996 Act explicitly authorizes state programs.[22] Before designing programs at either the state or federal level, however, some understanding is necessary concerning how the two systems might work together. Any federal program for assistance to rural, insular and high cost areas should accommodate and work harmoniously with rationally designed state programs.

The Act permits the states to establish their own universal service "mechanisms." Certainly states have established such mechanisms informally, usually in the form of rate designs that establish averaged rates between urban and rural areas.

Because of the breadth of the federal responsibility, however, explicit state programs to support universal service will be supplementary to the federal effort, and will be aimed at "additional definitions and standards."[23] For example, if the federal system supports emergency services, state programs might go farther and support enhanced 911, a program with additional features and

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[22] 1996 Act, Sec. 101(a), §254(f) (authorizes state programs). The present NPRM does not address the portion of the statute relating to state universal service programs. NPRM, paragraph 12.

[23] 1996 Act, Sec. 101(a), § 254(f).

significantly higher costs. States could also decide to go beyond "reasonably comparable" rates and establish "equal rates" as the state standard.

In conclusion, while the Act leaves room for the states to support, from state-raised funds, the universal availability of "additional" standards, the principal responsibility for raising and distributing funds lies with the Commission.

Supported Services

The 1996 Act requires the Commission to define "the services that are supported by Federal universal service support mechanisms" ("supported services").[24] The Commission should ensure that supported services are defined broadly enough to allow all parts of the country to receive quality services and to have access to advanced services.[25]

At the same time, the Commission should remain aware that each time a service is added to the definition of supported service, the demand for funding for universal service mechanisms may increase. If the Commission should decide to define "supported services" broadly, it must be prepared to appropriately enlarge the financial capacity of its universal service efforts.

The Subscriber Line Charge

In paragraphs 112-115 of its notice the Commission referred to the Federal-State Joint Board questions regarding the recovery of interstate-allocated subscriber loop costs. In particular, the Commission seeks comments regarding the advisability of reducing the carrier common line charge and increasing the existing Subscriber Line Charge (SLC) level. In support of the proposition of

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[24] 1996 Act, Sec. 101(a), § 254(a)(2). *See* paragraphs 15 through 23 of the NPRM.

[25] Act of 1996, §101(a), § 254(b)(3).

increasing the SLC, the Commission cites the comments of those persons who have argued that those costs associated with facilities dedicated to the use of a single subscriber should be recovered through a flat, non-traffic sensitive charge assessed on all end users.

While the Commenting States agree that economic theory may suggest that it is not economically efficient to recover non-traffic sensitive costs on a traffic sensitive basis, it does not follow that those costs must be recovered from end-users on a flat rated basis. From the perspective of economic efficiency, what is important is the flat structure of the charge and not who pays it. From the perspective of equity and fairness, however, those who pay the charge is most important. Interexchange carriers should pay a portion of the non-traffic sensitive loop cost because they use the local exchange carriers' loop plant as a part of the network by which they provide service to their customers. Any apparent conflict between efficiency and equity can be resolved in the following manner:

(1) All interstate NTS costs would be identified and reduced to a per line charge or rate.

(2) That charge or rate would then be assessed to the interexchange carrier to which the end user has presubscribed.

(3) If casual use of other carriers' services is made by the end user, a per line charge would be divided among all carriers using the common line on the basis of relative usage by each carrier.

(4) Interexchange carriers would be free to recover the flat charge made to them in any way the market will allow. This might be through a minimum bill, through collecting part or all of the end user customer charge, tapered usage rates, etc.) so long as the charges are made to the end user by the interexchange carrier and not the local exchange carrier.

One advantage of this mechanism would be greater consumer understanding. Consumers now tend to think that their only charges for interstate service are the per-minute charges billed to them by their interexchange carriers. They are often surprised to discover that a part of what they perceive as their bill for local service includes a non-optional $3.50 per month for the right to access the interstate network.

Interexchange carriers may recover this charge in a variety of ways from their customers. For some carriers, "Ramsey pricing" will dictate the imposition of flat end user charges. However, some carriers may choose to absorb that charge or part of it as a part of their cost of doing business, or to obtain a competitive advantage. As the market becomes more competitive, the various market participants may be less able to recover fixed (non-variable) costs through flat end-user charges. The plan advanced here will allow the marketplace to determine how NTS costs are ultimately recovered from end users rather than prescriptively requiring that they be recovered in all cases in the same way.

Smith v. Illinois Bell Telephone Company,[26] requires the establishment of a separations process to allocate a portion of NTS local exchange costs to the interstate jurisdiction. However, *Smith* does not dictate how the Commission may recover these costs once they have been assigned. Our proposal here is not only consistent with *Smith*, but is more consistent than the Commission's proposal to require payment of an end user charge that amounts to an increase in the local exchange rate. To impose all NTS costs (including the interstate portion) directly on the end user, as a condition of obtaining local service, would strip *Smith* of all practical effect. An examination of the ratemaking controversy settled by *Smith* unequivocally supports this proposition.

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[26] 282 U.S. 133 (1930).

Before the *Smith* decision, the greatest controversy over the setting of telephone rates was whether all the costs of providing local telephone loop plant should be collected through local exchange rates. Under the "board-to-board" theory, local exchange rates included all the costs of loop plant (now called NTS costs), as well as all local switching costs. Toll rates were based on toll costs which were defined to include only the cost of the toll switchboards as well as the interexchange transport equipment between the toll switchboards, giving rise to the term "board-to-board."

The alternative ratemaking theory, called "station-to-station" ratemaking, apportioned the costs of exchange loop plant and switching equipment between exchange and toll service. Station-to-station ratemaking is conceptually supported by the fact that all plant from the originating to the terminating telephone station, as well as local switching, are commonly used and absolutely necessary to complete toll calls. Since loop plant (now NTS plant) as well as local switching are jointly used for both tolls and local service their costs are apportioned between the two services under station-to-station ratemaking.

Before the Supreme Court decided *Smith*, most State regulatory commissions adopted the "board-to-board" principle of ratemaking.[27] *Smith* arose from a ratemaking case in which the Illinois Commerce Commission adopted "station-to-station" ratemaking because it felt that the "board-to-board" method improperly required exchange ratepayers to subsidize toll service. Although the United States District Court enjoined the Illinois Commerce Commission and required them to use Illinois Bell's preferred "board-to-board" ratemaking approach in *Illinois Bell Tel. Co. v. Moynihan*,[28]

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[27] *See e.g., Re: Indiana Bell Telephone Co.*, P.U.R. 1922C, 348 (Ind.); *Buck v. New York Tel. Co.*, P.U.R. 1921E, 798 (N.Y.).

[28] 38 F. 2d 77 (N.D. Ill. 1930).

the Supreme Court clearly abandoned "board-to-board" ratemaking when it reversed the District Court by saying that:

> [i]t is obvious that, unless an apportionment is made, the intrastate service to which exchange property is allocated will bear an undue burden.[29]

Any action by the Commission which reallocate NTS costs back to local exchange customers through a flat interstate charge that is a condition precedent to obtaining *local* service constitutes nothing short of a reimposition of the same "board-to-board" ratemaking theory rejected by the United States Supreme Court. An interstate end user charge collecting all interstate allocated NTS costs would nullify the very reason separations was created in the first place, to get away from "board-to-board" ratemaking. For *Smith* to logically mean anything, some portion of the NTS local exchange costs must be allocated to the interstate jurisdiction and be recovered by a means other than one which amounts to an increase in the local exchange rate.

When Congress enacted the most recent separations legislation, it reaffirmed a commitment to "station-to-station" ratemaking by recognizing that the toll network "would be worthless" without local telephone loop plant.[30] That policy can only be continued by assigning the interstate allocated NTS costs to the use to which they are put; to interexchange carriers and their ratepayers as we have suggested.

Moreover, before the policy decision is made to increase a non-optional, flat rate end user charge for the purpose of recovering a greater proportion of interstate NTS costs, the FCC must

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[29] *Smith v. Illinois*, supra, at p. 151, *See also* Gabel, *Development of separations principles in the Telephone Industry*, 24 (Mich. St. Univ. Press 1967).

[30] 117 Cong. Rec. S. 15,981 (1971).

determine what effect that increase in the level prices for telephone service will have on subscribership. Based on the study relied upon by the FCC in rendering its original decision in Docket No. 78-72, an increase of the magnitude necessary to eliminate the common line charge, could drive a significant number of Americans from the telephone network.[31]

We believe that the Commission should be wary of assuming that the affects of a substantial increase in the subscriber line charge can be sufficiently ameliorated by universal service mechanisms such as targeted subsidies. Although explicit universal service support mechanisms may help preserve universal telephone service in very high cost areas, an increased end user charge could permit significant increases in base entry level prices for service in some areas which have not been modeled and are not known at this time.

Similarly, lifeline mechanisms may be inadequate because once end-user charges are increased, an unknown but significant number of customers may be unable to afford the basic quality telephone service they enjoy today.

If the Commission is not inclined to shift the SLC from an end user charge to a charge paid by interexchange carriers, at the very least is should consider adjusting the SLC over time. Traffic sensitive access rates are currently capped and are subject to a productivity adjustment. With improvement of line concentration technology and build-out of Subscriber Line Carriers, there is no question that subscriber line costs are experiencing productivity improvements along with other cost of the public switched network. Consumers will not reap those productivity gains if a productivity adjustment is not applied to the SLC. Further, because the cost of subscriber line equipment is

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[31] *See Third Report and Order*, Appendix G, Table 3; The "Pearl I" study shows an approximate nine (9) percent drop-off rate with the proposed $6.00 end user plan. This study was submitted by AT&T as an exhibit in the Divestiture proceeding, "Pearl II" has been developed as a retreat from the Pearl I conclusions.

decreasing in both real and nominal terms, any increase of the SLC would be inconsistent with the trend of costs to carriers.

Administration of Support Mechanisms

Paragraphs 121 through 126 of the NPRM seek comment on how contributions to federal Universal Service mechanisms should be assessed. The statutory goals of equitable and nondiscriminatory contributions[32] and specific and predictable support mechanisms[33] can best and most equitably be met by spreading the funding burden across all services provided by any and all interstate providers in equal proportion to revenue.

Paragraph 123 of the NPRM suggests collecting contributions on net revenues, after subtracting revenues paid to other carriers. This amounts to an exclusion of wholesale transactions between carriers. The Commission should strive to avoid charging the same service twice, and this wholesale exemption should accomplish that purpose. This will ensure that the system is neutral as between carriers who purchase services at wholesale and those vertically integrated carriers who purchase relatively few components from others.[34]

Paragraphs 127 through 131 of the NPRM seek comment on fund administration. One option under consideration is appointment of a neutral fund administrator. Vermont has had a neutral fund administrator since 1994 for its Universal Service Fund. That administrator was selected for a three year contract from among seven competitors who submitted formal bids. Criteria

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[32] 1996 Act, Sec 101(a), § 254(b)4.

[33] 1996 Act, Sec 101(a), § 254(b)5.

[34] The Vermont Universal Service Fund has been operating successfully since October, 1994, using similar principles, although in Vermont the charge is assessed on the customer purchase, rather than on the carrier's revenue.

for selection included cost, ability to handle deposits and payments, ability to invest securely, and knowledge of the telecommunications industry. Telecommunications carriers were disqualified from bidding. Vermont also gave preference to bidders who offered the continuity of an existing institution, as opposed to individual bidders. The Vermont system, as administered by NECA, has been working well, and may be an adequate administrative model for a federal program.

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The Maine Public Utilities Commission recently completed a ratemaking proceeding in which it required NYNEX to provide discounted and/or free service to schools and libraries in Maine. Attached to these comments are the portion of the Maine Commission's Orders and press releases. These may be useful in providing guidance to the Joint Board.

Respectfully submitted,

for the
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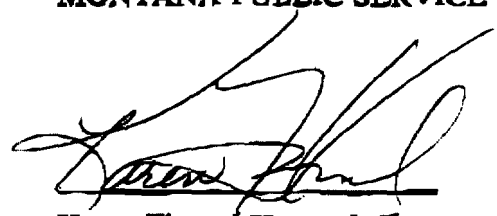

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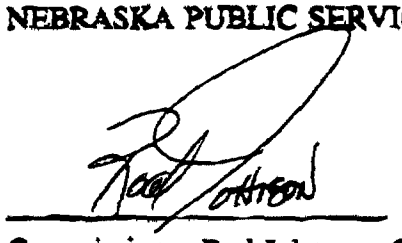

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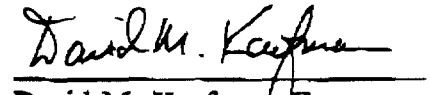

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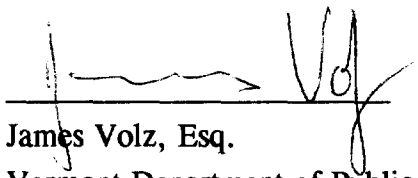

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Certificate of Service

I, Peter M. Bluhm, hereby certify that on this 11th day of April, 1996, copies of the foregoing comments of:

the state of Maine Public Utilities Commission,
the state of Montana Public Service Commission,
the state of Nebraska Public Service Commission,
the state of New Hampshire Public Utilities Commission,
the state of New Mexico State Corporation Commission,
the state of Utah Public Service Commission,
the state of Vermont Department of Public Service and
Public Service Board, and
the Public Service Commission of West Virginia

were served by first class mail, postage prepaid, to the parties listed on the attached service list.

Peter M. Bluhm

Dated: April 11, 1996

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STATE OF MAINE
PUBLIC UTILITIES COMMISSION

Docket No. 96-900

April 2, 1996

PUBLIC UTILITIES COMMISSION
NYNEX Schools and Libraries Project

ORDER

WELCH, Chairman; NUGENT and HUNT, Commissioners

On January 5, 1996 and February 16, 1996, we issued Orders implementing the provisions in our May 15, 1995 Order relating to NYNEX providing information networks and services to schools and libraries. Docket No. 94-123, *Public Utilities Commission, Investigation into Regulatory Alternative for the New England Telephone and Telegraph Company*; and Docket No. 94-254, *Frederic Pease, et al. v. New England Telephone and Telegraph Company d/b/a NYNEX*, Orders (May 15, 1995, Jan. 5, 1996, Feb. 16, 1996). In those Orders, we created a Schools and Libraries Advisory Board to oversee this project. The Advisory Board was directed to "develop and recommend for the Commission's approval procedures and timelines for implementing the Approved Plan" by April 5, 1996.

I. APPROVAL OF IMPLEMENTATION PLAN

During our deliberations on April 1, 1996, we considered the Board's proposal for implementing this project. We agree that NYNEX should proceed to implement the program as described in the Plan to Apply up to $4 Million Annually to Provide Access to Information Services and Networks for Maine's Libraries and Schools dated March 29, 1996 (the "Plan"). This Plan includes training to be administered by Maine Science and Technology Foundation and the provision of so-called backbone-tier services by the University of Maine System's Computer and Data Processing Services (CAPs). We make one change to the Plan in that we will require that the Advisory Board have the power to give final approval to the Maine Science and Technology Foundation's selection of contractors for training.

The Advisory Board also requested that we clarify certain other aspects of our Orders. We do so as described below.

II. CLARIFICATION OF ORDERS

A. Definition of Libraries

In our January 5, 1996 Order, we adopted the following definition of libraries as proposed by the Maine Library Association:

> public libraries as defined by statute, libraries in publicly funded institutions of higher education, the county law